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SUBJECT: UKRAINE: A VISIT TO AN UNDERGROUND GAS STORAGE FACILITY

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11. (SBU) Summary. EconOff and Econ Assistant traveled to the Ivano-Frankivsk Oblast in Western Ukraine to visit officials from the Prykarpattiatransgaz (PTG) gas transportation company, gas compressor stations and the underground gas storage facility near the town of Bogorodchany. Built between 1978-1989 to service Soviet gas exports to Europe, Bogorodchany's five gas compressor stations and its impressive underground gas storage facility continue to ensure transit of Russian natural gas to Europe and the storage of billions of cubic meters (bcm) of natural gas. The staff we visited took pride in their many years of service in the gas industry, and many were eager to share ideas to increase efficiency and reduce waste. However, NaftoHaz's poor financial health, low prices for Russian gas transit and storage, and the existence of intermediary UkrHazEnergo has cut into the profitability of regional pipeline operators like PTG and prevented them from modernizing what is one of Ukraine's most valuable strategic energy assets. End summary.

PTG's Role in Ukraine's Gas Transportation System

12. (SBU) Prykarpattiatransgaz (PTG) is one of six subsidiaries of Ukraine's state-owned gas pipeline operator Ukrtranshaz that manage gas pipelines across Ukraine. PTG handles almost all Russian gas transiting to Europe as it exits Ukraine to neighboring Hungary, Slovakia, Romania and Moldova. PTG's main assets include the Bogorodchany underground gas storage facility (UGS), and 5,000 km of gas pipelines that include portions of the three major transit trunk pipelines: Soyuz, Urengoi-Pomary-Uzhgorod, and Progress, as well as low-pressure local distribution pipelines. PTG's pipelines can pump up to 140 bcm of gas annually, but are currently operating somewhat below maximum capacity because of decreasing supplies of Russian gas.

The Bogorodchany Underground Gas Storing Facility

13. (U) The Bogorodchany underground gas storage facility is located 18 km from Ivano-Frankivsk on a depleted natural gas field. According to UGS Director Leopold Mysliborskiyy, who has headed the facility since construction began in 1978, the storage facility was built in record time by 5,000 Polish workers hired by the Soviet government after the USSR had to pay tens of millions of dollars in fines for failure to supply an agreed amount of gas to Western Europe. The UGS is located on a four square kilometer plot, and at first glance appears to be a normal agricultural field, but beneath the soil lies an overall gas capacity of 3.6 bcm, for both

retrievable gas and for the "buffer gas" needed to operate the storage facility. A total of 2.3 bcm of retrievable gas is currently stored in the facility. (Note: The total retrievable capacity of Ukraine's gas storage facilities is approximately 34 bcm.)

14. (SBU) The Bogorodchany UGS is the second largest gas storage facility in Ukraine, but the only one near the Western border of Ukraine that can be tapped into very quickly, allowing the retrieval of up to 50 million cubic meters (mcm) of gas per day. Ukraine has one larger facility in Lviv oblast, which holds about 16 bcm, but due to its geological characteristics drains more slowly than Bogorodchany. Mysliborskiyy told us that in a gas crisis, everyone would be turning to Bogorodchany to provide enough gas to weather a shortage, be it from natural or political causes. The UGS is connected to all three transit pipelines and lifted gas can be quickly pumped into the pipelines to increase gas supply to Europe during peak demand periods in the winter. PTG's Chief Engineer Yevstakhiy Kovaliv told us that the public was unaware that Gazprom tried unsuccessfully to take over the UGS three times, which in his view, validates the strategic importance of the UGS. He declined to be more specific when asked about Gazprom's unsuccessful takeover attempts.

Efficiency Efforts

15. (SBU) Built between 1978-1989, gas compressor stations in Bogorodchany are still functioning well, according to Kovaliv. Successful conservation efforts now allow PTG to save about 10 mcm of gas annually that was previously emitted into the atmosphere. This increase in efficiency was the result of the ability of PTG engineers to repair gas pipelines, which were operating under pressure, without halting gas flows. PTG officials told us that the

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compressor stations, pipelines, and the UGSS could become even more efficient with appropriate financial support from NaftoHaz and the GOU that would allow PTC to implement best practice efficiency programs. For now, officials commented, PTG employees generally make efficiency improvements using their own resourcefulness, expecting little financial support from the government.

Impact of UkrHazEnergo

16. (SBU) PTG management told us that the low prices for the transit and storage of Russian gas under current gas agreements between Russia and Ukraine have cut into the company's profitability, as has the creation of UkrHazEnergo (UHE), which has affected other regional gas transit companies as well. According to Kovaliv, PTG's ability to improve its financial standing took a devastating hit after UHE received a license for local gas distribution in Ukraine and Ukrtranshaz lost this market segment in 2007. (Note: Previously, PTG sold gas directly to industry and regional gas distributors. End note). Although PTG got rid of a consumer payment collection headache, it now completely depends on Ukrtranshaz's financial disbursements. At the same time, Ukrtranshaz depends financially on NaftoHaz and NaftoHaz has been rumored to be near bankruptcy for some time (reftel). The presence of UHE reduced the amount available for PTG and other pipeline operators to modernize antiquated infrastructure.

Co-Generation in PTG's Future?

17. So-called co-generation is another perspective area for energy efficiency in the Ukrainian gas transit sector. PTC uses gas from its pipelines to generate electricity to power some of its gas compressor stations. The small power plants have excess capacity that can be used to generate electricity for surrounding towns. According to PTG Chief Engineer Kovaliv, the co-generation potential at all Ukrainian gas compressor stations is enormous and could produce power equal to building a one thousand MW nuclear reactor. Additional improvement plans include installation of a large 75 MW co-generation unit that will produce heat and electricity for the

plant and a neighboring village. After a long search for investors, financing for this \$40 million project was provided by a Czech company that produces the necessary co-generation equipment. Co-generation plans and completed feasibility studies are underway for Dolyna, Odesa and seven other of PTG's gas compressor stations. Ukrtranshaz, however, lacks its own funds to implement such projects. Attracting outside investors is also difficult, as they would normally seek collateral from the pipeline operators, which isn't possible since local pipeline operators are all GOU-owned and their assets by law cannot be allowed to fall into private hands.

18. (SBU) Comment: The extensive pipeline system, gas compressor stations, and gas storage facility are important strategic assets for Ukraine that, if managed properly, can be a lucrative source of public sector income for years to come. We were impressed by the dedication and resourcefulness of the pipeline operator's management and workers, yet this dedication alone is not sufficient to maintain and modernize the pipeline network. Ukrtranshaz has been unable to provide or attract sufficient investment to subsidiary transit companies like PTG, in part because the lack of transparency on the part of Ukrtranshaz and its parent NaftoHaz have long deterred lenders and investors. Ukraine's current policy of negotiating arguably low fees for transit and gas storage and the ability of the gas middleman company UkrHazEnergo to divert profits from Ukrtranshaz have further stymied energy efficiency and growth in Ukraine's important gas transit and storage sectors. Unfortunately, it appears that PTG and other pipeline operators will not get the financial backing they need as long as the current policies governing gas transit and distribution are not overhauled. End comment.